UNITED STATES OF AMERICA
FEDERAL ENERGY REGULATORY COMMISSION

Before Commissioners: Pat Wood, III, Chairman;
William L. Massey, Linda Breathitt,
and Nora Mead Brownell.

Kern River Gas Transmission Company — Docket No. CP01-106-001

ORDER DENYING REHEARING

(Issued October 24, 2001)

The Firm Customers[1] of Kern River Gas Transmission Company have filed a request for rehearing of the Commission's April 6, 2001 order, which issued a certificate of public convenience and necessity authorizing Kern River to construct and operate its California Action Project.[2] The California Action Project is a compression-only expansion which will allow Kern River to provide an additional 135,000 Mcf per day of limited-term, incremental transportation capacity from Wyoming to California, beginning in July 2001, to help address the urgent need for additional energy in California. The Firm Customers contend that, as a result of a lack of sufficient take-away capacity in California, the sale of additional firm capacity on Kern River will unduly degrade their existing firm delivery rights.

For the reasons discussed below, we will deny the Firm Customers' request for rehearing. This order is in the public interest because the California Action Project provides the opportunity for additional, necessary natural gas supplies to move to California markets.

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[1]The Firm Customers consist of Aera Energy, LLC, Amoco Production Company, Chevron, U.S.A. Inc., Coral Energy, and Texaco Natural Gas, Inc.

[2]95 FERC ¶ 61,022 (2001).

I. BACKGROUND

A. Kern River's Proposal

Kern River's system extends nearly 900 miles from its Wyoming receipt points, through Utah and Nevada, to the San Joaquin Valley near Bakersfield, Kern County, California. Kern River's system has delivery points accessing various markets in Utah and southern Nevada. At its Daggett and Wheeler Ridge delivery points, respectively, Kern River interconnects with the two major California gas distributors, Pacific Gas & Electric Company (PG&E) and Southern California Gas Company (SoCalGas).

On November 15, 2000, Kern River filed an application in Docket No. CP01-31-000 for authority to construct and operate its 2002 Expansion Project. This project involves additional compression and metering facilities required to expand Kern River's system capacity from Wyoming to California to serve 124,500 Dth per day of new, firm, long-term contract demand, commencing May 1, 2002. Kern River proposed to treat the 2002 Expansion Project on a rolled-in basis. The primary markets for the shippers in the 2002 Expansion Project are existing and new electric generation markets in California. This application was amended on May 11, 2001 and was granted by the Commission on July 26, 2001.[3]

On March 15, 2001, Kern River filed its California Action Project, a compression-only expansion, which the company asked the Commission to approve on an accelerated basis, in order to provide additional capacity to California in time for the 2001 summer cooling season. Kern River stated that the California Action Project would

[3] Kern River Gas Transmission Co., 96 FERC ¶ 61,137.

use a combination of new permanent and temporary facilities,[4] to add a total of 53,900 ISO-rated horsepower (15,000 of which is temporary) to Kern River's system, at a total cost of approximately $81 million.[5]

Kern River requested approval of a two-part incremental rate for the proposed incremental firm capacity, derived using factors and methodology consistent with its last approved rate settlement, with the exception of a proposed 15.25 percent return on equity (ROE), representing a 2 percent ROE premium. The company proposed incremental fuel reimbursement rates, and to change the interruptible and authorized overrun service rates as set forth in its tariff to match the 100 percent load factor rate proposed for the incremental firm service. Kern River sought approval of pro forma tariff sheets to implement the proposed incremental transportation rate and associated incremental fuel rates.

Kern River conducted an open season for the California Action Project, following which it executed transportation service agreements with 40 different shippers, allocating to them, on a pro rata basis, all of the proposed incremental capacity. SoCalGas' Wheeler Ridge delivery point was allocated a total of 126,600 Mcf/d.

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[4] Kern River stated that, on the contemplated May 1, 2002, in-service of its pending 2002 Expansion Project, most of the California Action Project facilities, along with some additional facilities to be certificated in Docket No. CP01-31-000, will be utilized to provide 124,500 Dth per day of long-term, firm service for 2002 Expansion Project shippers. The excess design capacity available at that time due to the California Action Project facilities, 21,000 Mcf per day, will be used for California Action Project service until May 1, 2003, when the associated permanent facilities will be incorporated into Kern River's planned 2003 Expansion Project.

[5] The proposed facilities include: (1) three new compressor stations, the Elberta Compressor Station, the Veyo Compressor Station and the Daggett Compressor Station; (2) upgrades and restages for the compressor units at three existing compressor stations, the Muddy Creek Compressor Station, the Fillmore Compressor Station, and the Goodsprings Compressor Station; and (4) an upgrade at the existing Wheeler Ridge Meter Station. The compressor unit proposed for the new Daggett Compressor Station is a temporary facility, which subsequently will be replaced with a permanent compressor unit as part of Kern River's 2002 Expansion Project, authorized in Docket No. CP01-31-000. Upon conclusion of the California Action Project, Kern River states that the remainder of the proposed facilities will be permanently incorporated into either the 2002 or 2003 Expansion Projects.

B. Responses to the Proposal

Following public notice of the California Action Proposal, a number of parties intervened in the proceeding.[6] Four parties raised substantive issues.

The Firm Customers, PG&E, and SoCalGas expressed concern about the impact of the California Action Project on the reliability of firm service to existing customers at the Wheeler Ridge. The Firm Customers requested that, to ameliorate this problem, existing firm shippers who have Wheeler Ridge primary firm delivery point rights be given a priority over expansion shippers.

Amoco Production Company and BP Energy Company (Amoco) protested the rates for the California Energy Project, stating that Kern River had not provided sufficient support for the proposed incremental rate on the project, for the proposed fuel rates for the project, or for the proposed incentive rate of return. In consequence, Amoco asked the Commission to set Kern River's current transportation and fuel rates as the ceiling for the California Action Project, and to consolidate all expansion rate issues for further review. On another rate matter, the Firm Customers objected to Kern River's proposal to increase its rates for authorized overrun and interruptible services.

C. The April 6, 2001 Order

On April 6, 2001, the Commission issued an order granting the requested certificate.

We explained that, in light of the severe electric energy shortages facing California and other areas of the West in recent months, we have undertaken to do what we can to increase pipeline capacity, to help increase electric generation.[7] Given our recognition that California's energy situation has reached a stage where the time to react is very critical, we found that promptly expanding Kern River's system, thereby providing the opportunity to bring more natural gas supplies to a needy market, including electric power generation plants, would be consistent with our efforts to assist California.

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[6] These parties are listed in Appendix A to the April 6, 2001 order. 95 FERC at p. 61,064. Enron North America Corp. and Pacific Gas & Electric Co. also intervened timely, although their names were inadvertently not included in the appendix.

[7] See Removing Obstacles To Increased Electric Generation And Natural Gas Supply (Docket No. EL01-47-000), 94 FERC ¶ 61,272 (2001).

We stated that Kern River had demonstrated market demand for the California Action Project by executing firm service agreements covering the total 135,000 Dth/d of proposed capacity of the project.

The Commission found that Kern River's expansion project will not be subsidized by its existing customers because Kern River proposes to charge the California Action Project shippers an incremental rate. Moreover, with respect to Amoco's argument that the California Action Project shippers will subsidize future Kern River expansions, the Commission concluded that there was no showing that the rates paid by the shippers in this limited term project will have any impact on rates paid by customers in the future, and that the appropriate rates to be paid by shippers in any future Kern River expansions will be determined in those proceedings.[8]

With respect to the impact of the proposal on existing customers and competing pipelines, the Commission concluded that the California Action Project will not have undue negative impacts on existing shippers or competing pipelines. The Commission stated that the record does not show that pro rata allocations of primary firm capacity have been a problem at Wheeler Ridge. Also, the California Action Project shippers will have the ability to reduce their flows to Wheeler Ridge by flowing their gas to other points on the system, including the major Kern River interconnect with PG&E at Daggett and Kern River's planned direct connect delivery point to the new La Paloma power plant, which is downstream of Wheeler Ridge. Moreover, while SoCalGas expressed concern about the situation at Wheeler Ridge, it also indicated some willingness to provide additional capacity at that point.

More important, we explained that the solution to the problem of pro rata allocations of any services at Wheeler Ridge lies not with the interstate pipelines, but rather in fixing the problem with the take-away capacity and the lack of firm transportation path rights on SoCalGas, a matter which is beyond our jurisdiction. We stated the March 14 order had noted that the addition of new capacity to serve California and the West may be affected by the available local distribution capacity to deliver gas downstream of the interstate pipelines, and that the availability of sufficient local takeaway capacity is a matter controlled by the states rather than the Commission.

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[8]The Commission noted that costs associated with the facilities that will become permanent as part of the 2002 and 2003 Expansion Projects would be levelized over an approximate 15-year term and will be subject to the outcome of those proceedings.

Given our determinations that there is no issue regarding Kern River's ability to deliver all contacted-for volumes to Wheeler Ridge and other delivery points, and that the record did not show that firm shippers' rights will necessarily be degraded by allowing Kern River to ship additional supplies to meet California's urgent energy needs, we held that we would not, contrary to established policy, grant priority rights to existing customers. The Commission further noted that existing shippers with Wheeler Ridge as their delivery point will have a decided market advantage over the new California Action Project shippers with the same delivery point, because existing shippers pay a rolled-in system rate, while the expansion shippers will pay substantially higher incremental rates for the new capacity. The Commission also stated that the potential adverse impact on existing customers' service (the risk of being prorated) is offset to some extent by the settlement in Docket No. RP99-274-003[9] which, among other things, provides a 50/50 revenue sharing mechanism with maximum rate firm customers if Kern River receives revenues in excess of $177.3 million. In addition, the expansion to Kern River's system provides shippers with the opportunities and the flexibility to capture alternate markets outside of their primary delivery rights. Thus, Kern River's existing customers will receive several substantial benefits that occur as a direct result of the California Action Project.

On rate matters, the Commission rejected Kern River's proposed 15.25 percent return on equity, a 2 percent premium over its currently authorized return, because the company had not justified that proposal. The Commission found Kern River's proposed incremental fuel reimbursement rates to be appropriate as they are based on historical actuals, and directed Kern River to file tariff sheets to effectuate the proposed incremental fuel rates when it makes its section 4 filing to implement its incremental rate. The Commission explained that Kern River cannot change its rate for interruptible and authorized overrun service in this proceeding, but may make such a proposal in a section 4 filing.

On May 7, 2001, the Firm Customers filed a request for rehearing. The Firm Customers reiterate their arguments that providing additional firm capacity rights at Wheeler Ridge will degrade service to them. They append to their pleading affidavits showing that they have in recent months been subject to scheduling cuts of firm service of as high as 50 percent at the Wheeler Ridge.[10] They contend that the circumstances here

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[9] 90 FERC ¶ 61,124 (2000).

[10] One member of the Firm Customers, BP Energy Co., filed an affidavit for which it sought privileged and confidential treatment. We do not rely on that affidavit.

are similar to those in the El Paso case,[11] where shippers were rendered unable to utilize firm delivery point rights for which they had paid. The Firm Customers reiterate their request that the Commission either prohibit Kern River from selling additional primary firm capacity at Wheeler Ridge until there is sufficient take-away capacity at that point, or provide that any such sales have lower scheduling priorities than pre-existing contracts which designate Wheeler Ridge as a primary firm delivery point.

D. Approval of the 2002 Expansion Project

On July 26, 2001, the Commission issued an order authorizing Kern River to construct and operate the 2001 Expansion Project. The Firm Shippers raised similar issues in that proceedings to those they have raised here. By contemporaneous order, we are denying rehearing of the July 26, 2001 order.

II. DISCUSSION

The key issue here is what the Commission should do when presented with a request to expand interstate pipeline capacity, coupled with arguments that the connecting intrastate pipeline or pipelines may not be able to deliver all of the gas that is transported to them. Based on the evidence provided by the Firm Shippers, it indeed does appear that shippers are currently subject to pro rata allocations of their firm delivery rights at Wheeler Ridge. Adding additional interstate capacity to that point may exacerbate that situation.[12] That does not, however, mean that the appropriate solution to the problem is to preclude additional supplies from moving to the California market, or to grant current shippers a preference over new shippers.[13]

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[11] Amoco Energy trading Corp. v. El Paso Natural Gas Co., 93 FERC ¶ 61,060 (2000).

[12] It is not clear that it necessarily will do so, depending on what delivery points shippers choose to nominate, what capacity SoCalGas and other intrastate pipelines can make available, and other factors. For example, SoCalGas has announced plans to increase capacity on its system by the end of this year by about 375 MMcf/d (including 85 Mmcfd at Wheeler Ridge), or approximately an 11 increase in system capacity. See Energy Insight (May 16, 2001).

[13] The Firm Shippers contend that there is no evidence that the California Action Project shippers will not subsidize Kern River's 2002 expansion. They also contend that there is no evidence that Kern River will not over recover costs associated with the two

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The Firm Customers ' real quarrel is with the intrastate pipeline system. For whatever reasons, SoCalGas does not provide firm transportation capacity. Specifically, it provides no firm receipt point rights. Thus, it is not possible for firm shippers on interstate pipelines connecting with SoCalGas' system to obtain firm service on SoCalGas' system or the assurance that SoCalGas will, on any given day, deliver their gas to the ultimate consumer. Moreover, there is no way for such shippers or for end-users to contract for such certainty. The manner in which SoCalGas operates its system (i.e., shippers and end-users do not have the ability to acquire firm capacity rights), fosters an environment in which pro rata allocations on interstate pipeline can occur. Since we have no jurisdiction over the terms and conditions under which SoCalGas provides service, the Commission cannot eliminate this risk for the Firm Customers or other entities attempting to move gas into California.

The Firm Customer's argument is in effect based on the premise that purchasing firm transportation on Kern River's system somehow carries with it an entitlement to capacity on SoCalGas. That is not the case. Under its contracts with the Firm Customers, Kern River is obligated to deliver gas to Wheeler Ridge, or whatever other delivery points on its system that its shippers select. As discussed above, the Firm Customers do not allege that Kern River currently lacks the ability to meet this obligation, or that implementation of the California Action Project will overload Kern River's system. Thus, our approval of the California Action Project will not cause capacity constraints on the interstate system.

Under the Commission's regulations, shippers with upstream firm capacity are not guaranteed that they will be scheduled on downstream pipelines. For example, a shipper with firm capacity on an upstream pipeline and interruptible capacity on a downstream pipeline may not get scheduled for service if the downstream pipeline fails to confirm the upstream shipper's nomination.[14] In Order No. 637, the Commission determined that it

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projects, since both in part involve the same facilities. We will not permit Kern River to charge the California Action Project shippers for the project facilities and then seek reimbursement from the 2002 Expansion shippers for the same facilities, nor will we allow Kern River to subsidize any expansion through the rates charged to shippers on the California Expansion Project. As we stated in the April 6, 2001 order, the appropriate place to deal with such issues will be in prospective rates cases.

[14]See Regulation of Short-Term Natural Gas Transportation Services, Notice of Proposed Rulemaking, 63 Fed. Reg. 42982 (August 11, 1998), FERC Statutes and
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could not adopt a generic rule regarding allocation of gas supplies at pipeline interconnects. The Commission found only that "when pipelines do not have sufficient capacity at an interconnect to handle all nominations to that point, a shipper that has obtained firm capacity on both sides of an interconnect generally should have shipping priority over a shipper that is using interruptible transportation."[15] When, as in this case, a shipper has firm capacity on one side of a point and interruptible capacity on the other side, scheduling depends on whether the downstream pipeline is willing to confirm the shipper's nomination. In this instance, all firm shippers holding primary delivery point rights at Wheeler Ridge will receive equal service to that point. From there, all shippers have interruptible service on SoCalGas, and thus will be scheduled based on SoCalGas' available capacity, or on a pro rata basis. Like shippers that have purchased firm service on one interstate pipeline and interruptible service on a connecting pipeline, the Kern River shippers can have no expectation of guaranteed delivery of all their nominated volumes to the downstream pipeline.

It is true that, as the Firm Customers suggest, one way of dealing with their concerns would be to limit interstate deliveries to SoCalGas' city gate receipt points. However, all that this would do would be to lock in a competitive preference for Kern River's existing customers, to the potential detriment of all California natural gas consumers. To so limit interstate capacity would effectively eliminate competition to serve California markets, in complete contradiction to the open-market, pro-competitive policy that we have followed for many years.[16]

Moreover, as SoCalGas and other have argued in this proceeding, SoCalGas' capacity at any given receipt point may vary from day to day. It thus would appear impossible to determine exactly how much interstate capacity would match SoCalGas'

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[14](...continued)
Regulations, Proposed Regulations 1988-1998 ¶32,533, at 33,453-54 (July 29, 1998).

[15]Regulation of Short-Term Natural Gas Transportation Services, and Regulation of Interstate Natural Gas Transportation Services, III FERC Stats. & Regs., Regulations Preambles, ¶ 61,091 at p.31,307 (2000).

[16]In any event, limiting interstate deliveries from Kern River at Wheeler Ridge would not eliminate the Firm Customers' exposure to pro rata allocations, because intrastate deliveries made at Wheeler Ridge into SoCalGas' system, over which the Commission has no control, can result in capacity constraints.

system.[17] Indeed, to take the Firm Customers' argument to its logical conclusion, not only should we deny proposals to expand existing interstate capacity, we should also deny proposals for new pipelines, even those bringing new sources of gas to market, should they happen to interconnect at delivery points at which local distribution companies may be constrained.

In addition, a decision on our part not to allow the construction of additional interstate capacity to California would result in unclear signals being sent to the California market generally and, specifically, to the California local distribution companies. If transporters and consumers are willing to build and to pay for new transportation capacity, the California local distribution companies will have an understanding of how much demand there may be for capacity on their systems. If, on the other hand, we do not allow the market to express its intentions, the utilities will have a much poorer picture of the overall market.

We view this case as completely distinct from El Paso. As the Firm Customers admit, Kern River, unlike El Paso, provides specific receipt and delivery point rights. More important, there is no issue as to whether Kern River can bring to its delivery points every molecule of gas that it has contracted to transport, including the volumes to be provided via the California Expansion Project. It can, and the Firm Customers do not argue to the contrary.[18] Under these circumstances, to preclude a fully-subscribed

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[17]As we explained in the April 6, 2001 order, SoCalGas allocates capacity at Wheeler Ridge, not based on the physical constraints of the facilities there, but based on the previous days' nomination. Moreover, SoCalGas can take away almost 800 Mmcfd at Wheeler Ridge on many days, an amount greater than the aggregate primary firm delivery rights of shippers on interstate pipelines to that point. 95 FERC at pp. 61,059-60. Thus, constraints at that point appear to be operational or market-driven, rather than physical. Given this situation, even should we wish to determine what amount of interstate capacity would match intrastate capacity, we simply could not do so..

[18]The Firm Customers cite several other cases for the proposition that the Commission has permitted the sale of firm capacity that is subordinate to pre-existing shipper's firm rights. Columbia Gas Transmission Co., 55 FERC ¶ 61,366 (1991). 64 FERC ¶ 61,060 (1993); Panhandle Eastern Pipe Line Co., 75 FERC ¶ 61,084 (1996); Trunkline Gas Co., 78 FERC ¶ 61,025 (1997); Northern Natural Gas Co., 92 FERC ¶ 61,255 (2000), on reh'g, 95 FERC ¶ 61,088 (2001); Transwestern Pipeline Co., 90 FERC ¶ 61,076 (2000). However, those cases dealt with service that by its nature was less than absolutely firm (for example, Columbia involved off-peak firm, Panhandle,

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expansion of the interstate pipeline gird, or to lock in a preference for pre-existing shippers, would create an unjustified competitive advantage on behalf of those shippers. The California Action Project shippers have contracted for the overwhelming majority of the capacity to be delivered at Wheeler Ridge, their market of choice. To bar Kern River from selling capacity or to assign inferior rights to this capacity would not only contradict the clear intent expressed by the market, but likely would jeopardize the viability of the project.

In conclusion, we decline to deny Kern River's expansion proposal, or to place competitive disadvantages on expansion shippers, based on potential local capacity constraints that we have no authority to resolve.

The Commission orders:

The request for rehearing filed on May 7, 2001, by the Firm Customers is denied.

By the Commission. Commissioner Breathitt concurred with a
separate statement attached.

(S E A L)

Linwood A. Watson, Jr.,
Acting Secretary.

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[18](...continued)
Trunkline, and Northern involved limited term firm on existing facilities, and Transwestern involved backhauls). In each case, there was a question whether the pipeline had sufficient capacity to serve its existing and new customers, not a question whether a connecting local distribution company could take all the transported gas. As we have said, there is no question here that Kern River will have the capacity to meet all of its obligations to its firm customers, existing and expansion. In none of the cited cases did we preclude an interstate pipeline from fully using its capacity based on the competitive concerns of existing customers.

UNITED STATES OF AMERICA
FEDERAL ENERGY REGULATORY COMMISSION

Kern River Gas Transmission Company Docket No. CP01-106-001

Breathitt, Commissioner, concurring:

(Issued October 24, 2001)

I have written separately concerning Kern River's recent expansions in order to highlight what I consider to be an important issue: how FERC should respond to applications for interstate pipeline expansions when intervenors allege there is insufficient take-away capacity to ensure that additional gas supplies reach the markets where they are needed. I will not recite my every concern with how the Commission has addressed the parties' allegations of congestion at Wheeler Ridge and the potential effects of increasing interstate capacity at that point. In fact, I am pleased that, over the past six months, the Commission has come to acknowledge that our actions in certificating the Kern River expansions could exacerbate the problems of delivering natural gas to end-users in Southern California. More importantly, the Commission has recognized that the potential degradation of shippers' firm rights resulting from the certification of additional interstate capacity is an appropriate factor in the public benefits analysis the Commission uses to determine whether a project is in the public convenience and necessity.

I am relieved that certain events are occurring in California that will mitigate congestion at Wheeler Ridge. More take-away capacity is on the horizon, and the California Public Utilities Commission is considering certain regulatory relief that will facilitate the transportation of natural gas from Wheeler Ridge to the Southern California markets. Nonetheless, I remain uneasy about the strident policies the Commission has advanced in favor of certification of interstate capacity despite the insufficiency of take-away capacity, and particularly, the confidence with which the Commission has rejected the legitimate concerns of shippers on Kern River's system.

I am issuing a concurring opinion today to urge that we not lose sight of the panoply of issues we must consider in issuing natural gas pipeline certificates. In these times, there is great emphasis on expanding and improving our Nation's energy infrastructures. I most certainly share the sense of urgency to ensure adequate and reliable energy supplies. However, there is more to the Commission's mandate under the Natural Gas Act than simply getting more pipe in the ground. We must ensure that the pipeline facilities we certificate have the desired effect of bringing additional supplies to the areas where they are needed. We also must ensure that we take into account the potential for unused facilities, stranded costs, and unwarranted disruption of property rights and the environment.

The Commission has come a long way this year in understanding the physical constraints and regulatory impediments to natural gas transportation in California, but there is much to be done. We will revisit issues concerning the adequacy of take-away capacity in Kern River's pending certificate application in CP01-422-000. I will continue to advocate a thoughtful and coordinated approach to fostering badly needed interstate and intrastate expansion in California.

Linda K. Breathitt
Commissioner